



## MISSISSIPPI INSURANCE DEPARTMENT

MIKE CHANEY  
Commissioner of Insurance  
State Fire Marshal

MARK HAIRE  
Deputy Commissioner of Insurance

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WOOLFOLK BUILDING  
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June 8, 2011

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Post Office Box 79  
Jackson, Mississippi 39205-0079  
TELEPHONE: (601) 359-3569  
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**CERTIFIED MAIL  
RETURN RECEIPT REQUESTED**

Mr. John Mullen, Chief Executive Officer & President  
Direct General Insurance Company of Mississippi  
1281 Murfreesboro Road  
Nashville TN 37217-2432

**RE: Report of Examination as of December 31, 2009**

Dear Mr. Mullen:

In accordance with Miss. Code Ann. § 83-5-201 et seq. (Rev. 1999), an examination of your Company has been completed. Enclosed herewith is the Order adopting the report and a copy of the final report as adopted.

Pursuant to Miss. Code Ann. § 83-5-209(6)(a) (Rev. 1999), the Mississippi Department of Insurance shall continue to hold the content of said report as private and confidential for a period of ten (10) days from the date of the Order. After the expiration of the aforementioned 10-day period, the Department will open the report for public inspection.

If you have any questions or comments, please feel free to contact me.

Sincerely,

MIKE CHANEY  
COMMISSIONER OF INSURANCE

BY

Christina J. Kelsey  
Senior Attorney

MC/CJK/bs  
Encls. Order w/exhibit

**BEFORE THE COMMISSIONER OF INSURANCE  
OF THE STATE OF MISSISSIPPI**

**IN RE: REPORT OF EXAMINATION OF DIRECT GENERAL  
INSURANCE COMPANY OF MISSISSIPPI**

**CAUSE NO. 11-6257**

**ORDER**

**THIS CAUSE** came on for consideration before the Commissioner of Insurance of the State of Mississippi ("Commissioner"), or his designated appointee, in the Offices of the Commissioner, 1001 Woolfolk Building, 501 North West Street, 10th Floor, Jackson, Hinds County, Mississippi, pursuant to Miss. Code Ann. § 83-5-201 et seq. (Rev. 1999). The Commissioner, having fully considered and reviewed the Report of Examination together with any submissions or rebuttals and any relevant portions of the examiner's work papers, makes the following findings of fact and conclusions of law, to-wit:

**JURISDICTION**

**I.**

That the Commissioner has jurisdiction over this matter pursuant to the provisions of Miss. Code Ann. § 83-5-201 et seq. (Rev. 1999).

**II.**

That Direct General Insurance Company of Mississippi is a Mississippi-domiciled Company licensed to write Accident & Health; Automobile Physical Damage/Liability; Casualty/Liability; Fire/Allied Lines; Home/Farm Owners; Inland Marine; Plate Glass; and Trip Accident and Baggage coverages.

## FINDINGS OF FACT

### III.

That the Commissioner, or his appointee, pursuant to Miss. Code Ann. § 83-5-201 et seq. (Rev. 1999), called for an examination of Direct General Insurance Company of Mississippi and appointed David Daulton, Examiner-In-Charge, to conduct said examination.

### IV.

That on or about April 30, 2011, the draft Report of Examination concerning Direct General Insurance Company of Mississippi for the period of January 1, 2007 through December 31, 2009, was submitted to the Department by the Examiner-In-Charge, David Daulton.

### V.

That on or about May 13, 2011, pursuant to Miss. Code Ann. § 83-5-209(2) (Rev. 1999), the Department forwarded to the Company a copy of the draft report and allowed the Company a 15-day period to submit any rebuttal to the draft report. The Department received the Company's response to the report in a letter on or about May 27, 2011, and in response thereto, minor revisions were made to the report.

## CONCLUSIONS OF LAW

### VI.

The Commissioner, pursuant to Miss. Code Ann. § 83-5-209(3) (Rev. 1999), must consider and review the report along with any submissions or rebuttals and all relevant portions of examiner work papers and enter an Order: (1) adopting the Report of Examination as final or with modifications or corrections; (2) rejecting the Report of Examination with directions to reopen; or (3) calling for an investigatory hearing.

**IT IS, THEREFORE, ORDERED**, after reviewing the Report of Examination, the Company's rebuttal, and all relevant examiner work papers, that the Report of Examination of Direct General Insurance Company of Mississippi, attached hereto as Exhibit "A", should be and same is hereby adopted as final.

**IT IS FURTHER ORDERED** that a copy of the adopted Report of Examination, accompanied with this Order, shall be served upon the Company by certified mail, postage pre-paid, return receipt requested.

**IT IS FURTHER ORDERED** that the Mississippi Department of Insurance shall continue to hold the content of this report as private and confidential for a period of ten (10) days from the date of this Order, pursuant to Miss. Code Ann. § 83-5-209(6)(a) (Rev. 1999).

**IT IS FURTHER ORDERED**, pursuant to Miss. Code Ann. § 83-5-209(4) (Rev. 1999), that within thirty (30) days of the issuance of the adopted report, Direct General Insurance Company of Mississippi shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related orders.

**IT IS FURTHER ORDERED** that Direct General Insurance Company of Mississippi take the necessary actions and implement the necessary procedures to ensure that all recommendations contained in the Report of Examination are properly and promptly complied with.

**SO ORDERED**, this the 8<sup>th</sup> day of June 2011.

  
MIKE CHANEY  
COMMISSIONER OF INSURANCE  
STATE OF MISSISSIPPI

**CERTIFICATE OF MAILING**

I hereby certify that a true and correct copy of the above and foregoing Order and a copy of the final Report of Examination, as adopted by the Mississippi Department of Insurance, was sent by certified mail, postage pre-paid, return receipt requested, on this the 8<sup>th</sup> day of June 2011, to:

**Mr. John Mullen, Chief Executive Officer & President  
Direct General Insurance Company of Mississippi  
1281 Murfreesboro Road  
Nashville, TN 37217-2432**

  
Christina J. Kelsey  
Senior Attorney

Christina J. Kelsey  
Senior Attorney  
Counsel for the Mississippi Department of Insurance  
Post Office Box 79  
Jackson, MS 39205-0079  
(601) 359-3577  
Miss. Bar No. 9853



# **Mississippi Insurance Department**

## **Report of Examination**

**of**

### **DIRECT GENERAL INSURANCE COMPANY OF MISSISSIPPI**

**4734 North State Street  
Jackson, MS 39206**

**As of December 31, 2009**

**NAIC Group Code 1213  
NAIC Company Code 10889  
NAIC ETS No. MS029-F1**

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**EXAMINER'S AFFIDAVIT AS TO STANDARDS AND  
PROCEDURES USED IN AN EXAMINATION**

State of Tennessee,

County of Davidson,

David Daulton, CFE, being duly sworn, states as follows:

1. I have authority to represent the Commissioner of Insurance in the examination of the State of Mississippi in the examination of Direct General Insurance Company of Mississippi.
2. The Mississippi Insurance Department is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination work papers and examination report, and the examination of Direct General Insurance Company of Mississippi as of December 31, 2009, was performed in a manner consistent with the standards and procedures required by the Commissioner of Insurance of the State of Mississippi.

The affiant says nothing further.



David Daulton, CFE  
Examiner

Subscribed and sworn before me by David Daulton on this 2nd day of June, 20 11.

(SEAL)

Stephanie D. Johnson  
Notary Public



My commission expires NOV. 05, 2014 [date].



## MISSISSIPPI INSURANCE DEPARTMENT

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**MIKE CHANEY**

Commissioner of Insurance  
State Fire Marshal

**MARK HAIRE**

Deputy Commissioner of Insurance

April 30, 2010

Honorable Mike Chaney  
Commissioner of Insurance  
Mississippi Insurance Department  
1001 Woolfolk Building  
501 North West Street  
Jackson, Mississippi 39201

Honorable Joseph Torti III, Chairman  
Financial Condition (E) Committee, NAIC  
Deputy Director and Superintendent of Insurance  
Division of Insurance Regulation  
1511 Pontiac Avenue, Bldg 69-2  
Cranston, Rhode Island 02920

Dear Sirs:

Pursuant to your instructions and authorization and in compliance with statutory provisions, an examination has been conducted, as of December 31, 2009, of the affairs and financial condition of:

**DIRECT GENERAL INSURANCE COMPANY OF MISSISSIPPI**  
**COMPANY LICENSE # 9700042**  
**NAIC COMPANY CODE 10889**  
4734 North State Street  
Jackson, MS 39206

This examination was commenced in accordance with Miss. Code Ann. § 83-5-201 et seq. and was performed in Nashville, Tennessee, at the Administrative Office of Direct General Insurance Company (Company). The report of examination is herewith submitted.

## **SCOPE OF EXAMINATION**

The Company was last examined by representatives of the Mississippi Department of Insurance (MID) as of the period ending December 31, 2006. The present examination was conducted by Huff, Thomas and Company (Huff Thomas) and covered the period from January 1, 2007 through December 31, 2009, and included any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination. The examination field work was completed on April 30, 2011.

This examination was a full scope financial examination that included assessing the Company's financial condition, its ability to fulfill and manner of fulfillment of its obligations, the nature of its operations, and compliance with the law.

Robert Daniel, FCAS, MAAA, of Merlinos & Associates, Inc., a consulting actuary appointed by the MID, conducted a review of the Company's reserves as of December 31, 2009.

This examination was conducted in accordance with procedures recommended by the National Association of Insurance Commissioners ("NAIC") *Financial Condition Examiners Handbook*. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the company by obtaining information about the Company, including corporate governance, identifying assessing inherent risks within the company, evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions, when applicable to domestic state regulations. All accounts and activities of the Company were considered in accordance with the Risk-Focused examination process.

Reporting in the comments and recommendations section of this report was by exception; therefore, items that were tested and deemed acceptable by the examiners without material change received little or no comment.

## **COMMENTS AND RECOMMENDATIONS OF PREVIOUS EXAMINATION**

1. In the previous examination report, a recommendation was made that the actuarial opinion did not include documentation of the calculations of the ULAE/AOE reserve. Rather, it referred to the appointed actuary's review of Company work papers containing the ULAE reserve calculation. The Company work papers were not made part of the actuarial report and were not readily available for examination. The ULAE reserve work papers were subject to the report maintenance requirements per the annual statement instructions. This recommendation was also made in the examination as of December 31, 2003.

Based on our review of both the Opinion and the Actuarial Report as of December 31, 2009, it was determined that the Company has complied with this recommendation.

2. Documentation of material ceded reserve credits should be fully supported in the actuarial report supporting the Statement of Actuarial Opinion. This documentation should be sufficient for another actuary practicing in the same field to evaluate the work.

We reviewed the Report supporting the Statement of Actuarial Opinion and determined that the issue is no longer material given the Company's elimination of their quota share and loss corridor reinsurance structure and merits no further investigation.

## **HISTORY OF THE COMPANY**

On October 10, 1997, the Company was incorporated under the laws of the State of Mississippi and commenced business on May 7, 1998, with its principal office located in Nashville, Tennessee.

The original Articles of Association authorized 100,000 shares of \$50 par value capital stock. The Company's initial capitalization consisted of Direct General Corporation (DGC) purchasing 12,000 shares of the authorized capital stock for an aggregate purchase price of \$2,002,698. On December 28, 2001, the Articles of Association were amended to increase the Company's capital stock par value to \$100 per share.

Effective December 31, 2001, all outstanding shares of the Company were contributed in the form of a capital contribution from DGC to one of its property and casualty insurance subsidiaries, Direct General Insurance Company (DGIC).

On March 28, 2007, MID approved a merger with Elara Holdings, Inc. an affiliate of Calera Capital, TPG Capital and Elara Merger Corporation. Under the terms of this agreement, Elara Holdings, Inc. acquired all of the outstanding common stock of DGC. This merger removed the DGC and affiliates from U.S. Security and Exchange Commission regulatory authority since they are no longer public.

## **CORPORATE RECORDS**

### **Minutes**

The Board of Directors and Shareholder meeting minutes were reviewed for the period under examination through the fieldwork completion date and significant actions taken during each meeting were noted. It was noted that the annual meetings and other regular Board meetings were held in accordance with the Company's Bylaws. The Company made no amendments to its Articles of Incorporation and Bylaws during the examination period.

## MANAGEMENT AND CONTROL

### Capital Stock

As of December 31, 2009, the Company had issued and outstanding twelve thousand (12,000) shares of common capital stock with a par value of \$100 per share. DGIC owned 100% of the outstanding shares. During the examination period, \$1,838,725 in dividends were paid to DGIC.

### Board of Directors

The Articles of Incorporation and Bylaws vest the management and control of the Company's business affairs with the Board of Directors (Board). The members of the duly elected Board, along with their number of years as Director, and principal occupation, at December 31, 2009, were as follows:

Name and Residence	No. of Years as Director	Principal Occupation
Daniel Tarantin	2	Chief Executive Officer
Scott Bojczuk	2	Executive VP, General Counsel
Todd Hagely	10	Executive VP, CFO & Treasurer

### Committees

Prior to June 2009, the Company had an investment committee. The board meeting held on June 9, 2009 resolved that investment matters were routinely addressed by the board at Elara Holding, Inc. (Elara) and there was no need to maintain a separate investment committee. Following the discussion, the board unanimously adopted a resolution to discontinue the investment committee at the Company's level.

### Officers

Name	No. of Years as Officer	Title
Daniel Tarantin	2	Chief Executive Officer
James R. Dickson III	2	President
Scott J. Bojczuk	2	Executive VP, General Counsel
John T. Hagely	10	Executive VP, CFO & Treasurer
Craig E. Hamway	2	Executive VP, Marketing & Business
Johnathan G. Walters	1	Senior VP & Finance

David J. Newman	2	Senior VP Finance
Kimberly W. Nowell	2	Senior VP Human Resources
John F. Campbell Jr.	1	Senior VP Insurance Products
Brian T. Hanrahan	10	VP Actuarial Group
Timothy G. Thomas	1	VP Insurance Operations
Amy M. Samford	2	VP Assistant Secretary
Rebecca M. Baggett	4	Assistant Secretary
Constance A. Collins	10	Assistant Secretary
Jonahtan R. Dowell	1	Assistant Secretary

### **Conflict of Interest**

The Company has in place an established conflict of interest policy and procedures for the disclosure of any material interest or affiliation by any Director, Officer or key employee, which is likely to conflict with their official duties. Signed statements for Officers and Directors serving as of December 31, 2009 were reviewed without exception.

### **Corporate Governance**

The minutes of the meeting of the Stockholder and Board taken during the period covered by the examination, were reviewed and appeared to be complete and in order with regard to recording action on matters brought up at these meetings for deliberation, included the approval and support of the Company's transactions and events.

Management activities reviewed and approved by the Board include among other things, Performance/Financial Reports, Legal and Regulatory update, Reinsurance Programs, Market Conduct Reports, Company Performance, Budgets, Claims, investment results and other reports. Each member of the Board also serves as an executive officer and/or on the Boards for certain affiliated companies in the holding company organization.

Management reviews various data in an effort to identify trends and ensure accurate disclosure in the financial statement. Budget and actual operating results are compared monthly by Management.

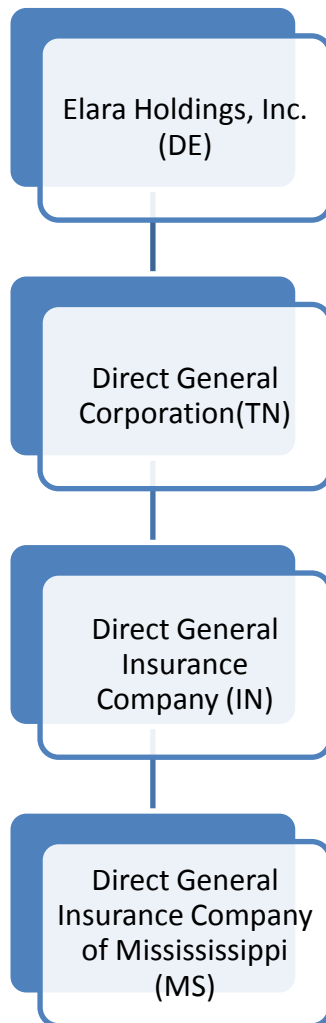
The President and CEO meet with his executive staff on a weekly basis facilitating the dissemination of information on key issues impacting the organization. The President and CEO also sit on the parent company's board of directors so they are able to report on matters directly to and from the board as appropriate.

## HOLDING COMPANY STRUCTURE

### Organizational Chart

The Company was a member of an insurance holding company system as defined with Miss. Code Ann 83-6-1. Holding Company Registration Statements were filed during the examination period with MID in accordance with Miss. Code Ann 83-6-5 and 83-6-9. The statements and applicable amendments that were filed with MID during the examination period were reviewed and it appeared that any changes and material transactions by and between the Company and its affiliates were disclosed appropriately.

The following organizational chart displays the direct line of ownership along with a brief description of each member:



Elara Holdings, Inc.(Elara): Elara is a privately-held financial services holding company whose principal operating subsidiaries provides non-standard personal automobile insurance, term life insurance, premium finance and other consumer products and services primarily in the southeastern United States. Elara was formed in 2006 to acquire all of the outstanding common stock of the outstanding common stock of Direct General Corporation which was publicly traded prior to the transaction.

Elara owns five property/casualty insurance companies, two life/health insurance companies, two premium companies, twelve insurance agencies, two administrative service companies and one company that provides non-insurance consumer products and services.

Elara had no assets, liabilities, or operations prior to the acquisition of DGC on March 30, 2007. As a result, Elara essentially continued as the same organization after the transaction. The company was purchased by 2 venture capital firms, TPG and Calera Capital on March 30, 2007.

Direct General Corporation (DGC): This Company was incorporated on September 28, 1993, for the purpose of serving as the ultimate parent company for Direct General's Holding Company System. Through its subsidiaries, DGC's core business involved the issuance of nonstandard personal automobile insurance policies throughout most of the southeastern United States. Through its premium finance operations, the premium charges for the majority of the insurance policies sold by the Company were financed, with collateral being the related unearned premium associated with the policy sold.

Direct General Insurance Company(DGIC): DGIC was incorporated under the laws of the State of Florida on December 15, 1990 as Independent Property and Casualty Insurance Company ("ICP"), and began operations on January 1, 1991. Effective March 6, 1997, in contemplation of the company being sold to DGC, IPC redomesticated to the State of Tennessee. On March 14, 1997, DGC acquired all of the outstanding capital stock of IPC and its name was changed to its present title. Effective December 27, 2000, DGIC was redomesticated to South Carolina. Effective December 20, 2007, DGIC was redomesticated from South Carolina to Indiana. At December 31, 2009, DGIC was authorized to write one or more lines of business in the State of Alabama, Florida, Georgia, Illinois, Indiana, Kansas, Mississippi, Missouri, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas and Virginia.

### **Affiliated and Related Party Transactions**

Below is a description of Inter-company Agreements to which the Company is a party.

Cost Sharing Agreement(s):The Company was party to an inter-company cost sharing agreement, whereby affiliates of the Company provided underwriting and policy issuance, claims settlement, premium financing, and administrative service for the Company. A copy of the Intercompany Cost Allocation Agreement was provided with Annual Registration Statement for December 31, 2009. Per this agreement the Company paid \$6,467,294 and \$5,566,113 for 2009 and 2008, respectively. During the examination it was identified that the cost sharing agreements



was not in compliance NAIC Accounting Practices and Procedure Manual SSAP 96. **See the “Comments and Recommendations” section of this report for further explanation on this exception.**

Reinsurance Settlement Agreement(s): The Company was party to a Reinsurance Settlement Agreement with the other property and casualty parent and affiliates. Because from time to time certain third party reinsurers who participate in the Direct General Group reinsurance program may remit settlements on a consolidated basis to an individual participating insurer, the Reinsurance Settlement Agreement was drafted to document the procedures for distributing funds received from reinsurers to ensure that each participating insurer in the Direct General Group obtains the proceeds to which it is entitled under applicable reinsurance agreements. The Company filed a copy of the intercompany Reinsurance Settlement Agreement and a Notice of Prior Transaction on Form D with the MID as of June 30, 2006.

Intercompany Producer Agreements: The Company was party to a producer agreement with its affiliated insurance agencies, Direct General Insurance Agency, and Right Choice Insurance Agency, whereby management could pay commission up to 15% on written premiums to its agencies. By letter dated November 18, 2005, the MID advised it had determined the intercompany producer agreements are outside the purview of Miss. Code. Ann. 83-6-21(2)(d) and therefore are not required to be filed for approval. Per this agreement the Company paid \$3,280,578 and \$3,516,258 for 2009 and 2008, respectively.

Premium Finance Agreements: The Company and Direct General Group premium finance companies are party to a premium finance settlement agreement. This agreement documents the duties and obligations between the parties relating to the settlement of accounts for financed insurance premiums and return unearned premium arising out of insurance premium finance agreements. The Direct General Group premium finance companies obligations to the Direct General Group insurers consist entirely of cash premium remittances arising out their extensions of credit for premium payments to insured have and proposed insured's. The Company filed a copy of the intercompany Premium Finance Settlement Agreement and a Notice of Prior Transaction on Form D with the MID on June 30, 2006.

Intercompany Tax Allocation Agreements: With the exception of Direct General Life Insurance Company and Direct Life Insurance Company, Direct General Corporation's subsidiaries that are greater than 80% owned are consolidated for federal income tax purposes. A consolidated federal income tax allocation agreement for 1995 and subsequent years was entered into by the companies. During the examination it was identified that this intercompany tax allocation agreements was not in compliance with NAIC Accounting Practices Procedure Manual, SSAP 96. **See the “Comments and Recommendations” section of this report for further explanation on this exception.**

## **FIDELITY BOND AND OTHER INSURANCE**

The Company, through its holding company, Elara protects itself against loss from any fraudulent or dishonest acts by any employees through a fidelity bond issued by the National Union Fire Insurance Company of Pittsburgh, PA. The bond has an aggregate loss coverage limit of \$15 million, and a single loss limit of \$7.5 million with a \$100,000 deductible. This bond meets the suggested minimum coverage prescribed by the NAIC. The Company also through Elara has professional liability coverage with a \$10 million limit and \$1 million retention. Other major insurance coverages in force at December 31, 2009 were as follows:

Commercial Umbrella	Commercial Property
Commercial Automobile	Workers' Compensation
Directors & Officers	

## **PENSIONS, STOCK OWNERSHIP AND INSURANCE PLANS**

Benefits provided to directors or officers were provided through DGIC's administrative service subsidiary, Direct Administration, Inc. The Company did not have any direct employees or agents.

## **TERRITORY AND PLAN OF OPERATION**

The Company commenced writing nonstandard private passenger automobile insurance policies in Mississippi in May 1998 and in Kentucky in August 2002. These policies, which are generally issued for the minimum limits of coverage required by state laws, provide coverage to drivers who cannot obtain insurance from standard carriers due to a variety of factors, including the lack of flexible payment plan, the failure to maintain continuous coverage, age, prior accidents, driving violations, occupation and type of vehicle. Affiliate insurance agencies sell the Company's products directly through neighborhood sales offices. In early part of 2006, the Company introduced telephone sales as a new distribution system. In May 2007, the Company introduced web sales as another distribution system. In 2009, geographical breakdown of direct premium writing was Mississippi \$23,165,000 (66%) and Kentucky \$11,914,000 (34%). Approximately 83% of the policies sold are financed by an affiliated premium finance company.

## **GROWTH OF COMPANY**

The following exhibit depicts the Company's financial results throughout the examination period:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Total admitted assets	\$47,041,744	\$46,232,857	\$47,325,012
Total liabilities	31,856,138	32,738,802	32,794,374
Capital	1,200,000	1,200,000	1,200,000
Surplus	15,185,606	14,141,814	14,530,638
Net Income	1,159,445	928,034	1,845,095
Gross premiums written	34,493,648	35,078,799	36,921,034
Net premiums written	34,385,524	34,969,198	36,787,476

The Company has reported positive net income in all three years under examination.

The following exhibit shows the underwriting results of the Company for the period under examination. The amounts were compiled from the Company's filed Annual Statements and from examination results:

Year	Premiums <u>Earned</u>	Losses & LAE <u>Incurred</u>	<u>Expenses Incurred</u>	<u>Combined Ratio</u>
2009	\$34,548,057	\$27,002,792	\$7,526,871	99.9%
2008	36,026,878	30,013,573	7,134,168	103.1%
2007	37,675,088	28,767,692	7,988,663	97.56%

A combined ratio of losses and LAE incurred and expenses incurred to premiums earned in excess of 100% typically indicates an underwriting loss. As indicated from the ratio column above, the Company experienced one year underwriting loss in the last three years of the examination period.

## **REINSURANCE**

Prior to 2006, the Company ceded premium and losses to other insurance companies under various quota share and excess of loss reinsurance agreements in order to provide the Company with increased capacity to write larger volumes of business while limiting its exposure to losses. The Company's income from operations, coupled with capital contributions from its parent, DGIC, has enabled it to increase its retention of direct business written over the past three years.

In 2006, the quota share reinsurance program was eliminated.

### **Reinsurance Assumed**

As of December 31, 2009, the Company did not assume any business.

### **Reinsurance Ceded**

The Company maintains joint reinsurance agreements with all property and casualty members of the Direct General Group. Effective January 1, 2009, the Company entered into a property catastrophic excess loss reinsurance treaty that provides a limit of \$10 million of coverage in excess of \$2 million retention on gross losses. The treaty covers in force, new, renewed, and assumed private passenger automobile physical damage business with maximum value per vehicle covered of \$75,000. The reinsurers for 2009 are Endurance Specialty Insurance Ltd., QBE Reinsurance Corp., Re Ltd., and certain underwriters from Lloyds.

### **Reinsurance Intermediary**

The Company used the services of Guy Carpenter and Company, Inc., a reinsurance intermediary, to place reinsurance with various reinsurers. Guy Carpenter and Company, Inc. was licensed and authorized by the MID and had the authority to procure placement certificates from various reinsurers in the Company's reinsurance ceded program.

### **Reserves:**

Benny Yuen, ACAS, MAAA, Senior Manager with the firm of Ernst & Young, L.L.P., is the Company's Appointed Actuary. Mr. Yuen was appointed by the Board of Directors on June 9, 2009 to render an opinion on the reserves of the Company. Mr. Yuen has provided the Company's actuarial opinion for the years ended December 31, 2008 and 2009.

The scope of the opinion was to examine the loss and loss adjustment expense reserves of the Company. In forming the opinion, information prepared by the Company was relied upon. This information was evaluated for reasonableness and consistency. The 2009 opinion stated the reserves: A) meet the requirements of the insurance laws of Mississippi Dept of Insurance; B) are consistent with reserves computed in accordance with accepted loss reserving standards and principles; and C) make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements. Mr. Yuen estimated loss and LAE reserves for the company were estimated net of salvage & subrogation.

During the examination, it was determined by the MID consulting actuary, Robert Daniel, FCAS, MAAA, of Merlinos & Associates, Inc., that the significant actuarial items in the Company's 2009 Annual Statement are materially correct and fairly stated in accordance with statutory accounting practices prescribed or permitted by the MID.

## ACCOUNTS AND RECORDS

The Company's 2009 trial balance was compared and agreed to the respective financial statements and schedules in the 2009 Annual Statement without exception.

The Company's accounts and records are maintained using electronic data processing with the exception of certain items entered manually into the general ledger. The Company maintains adequate supporting work papers which were reviewed during the examination. From a review of the internal controls and the Company's disaster recovery plan, it was determined that the current information system possesses most of the physical and internal controls as prescribed by the NAIC.

The Company's independent auditors issued unqualified opinions on the Company's audited financial statements for each year during the examination period. No material exceptions were noted when agreeing the Company's audited financial statements to the respective annual statements. All of the independent audit work papers were made available to the examiners during the examination.

## STATUTORY DEPOSITS

The Company's statutory deposits with the State of Mississippi complied with Miss. Code Ann. § 83-19-31 (2). The Following chart displays the Company's deposits at December 31, 2009:

<u>Type of Security</u>	<u>State Deposit</u>	<u>Par Value</u>	<u>Book Value</u>	<u>Fair Value</u>
FHLB	Mississippi	\$ 260,000	\$ 260,826	\$ 260,514
FHLB	Mississippi	345,000	345,000	345,711
MS State Rev	Mississippi	<u>400,000</u>	<u>400,000</u>	<u>403,636</u>
Totals		<u>\$ 1,005,000</u>	<u>\$ 1,005,826</u>	<u>\$ 1,009,861</u>

## FINANCIAL STATEMENTS

The following financial statements consist of a Statement of Admitted Assets, Liabilities, Surplus and Other Funds at December 31, 2009, a Statement of Income for year ended December 31, 2009, a Reconciliation of Capital and Surplus for the examination period ended December 31, 2009, a Reconciliation of Examination Adjustments to Surplus.

**DIRECT GENERAL INSURANCE COMPANY OF MISSISSIPPI  
STATEMENT OF ADMITTED ASSETS  
DECEMBER 31, 2009**

Bonds	\$ 37,623,556
Cash and short-term investments	4,480,174
Investment income due and accrued	366,080
Uncollected premiums and agents' balances in the course of collection (premiums and considerations)	1,918,340
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,145,771
Amounts recoverable from reinsurers	178,591
Net deferred tax asset	1,288,704
Receivable from parent, subsidiaries and affiliates	160
Aggregate write-ins for other invested assets	<u>40,368</u>
 Total Admitted Assets	 <u><u>\$ 47,041,744</u></u>

**DIRECT GENERAL INSURANCE COMPANY OF MISSISSIPPI  
LIABILITIES, SURPLUS AND OTHER FUNDS  
DECEMBER 31, 2009**

Losses	\$ 11,771,642
Loss adjustment expenses	532,575
Commissions payable, contingent commissions and similar charges	307,777
Other expenses	99,482
Taxes, License and fees	167,218
Current federal and foreign income taxes	527,412
Unearned premiums	17,253,225
Ceded reinsurance premiums payable	163
Funds held by company under reinsurance treaties	70,710
Payable to parent, subsidiaries and affiliates	1,125,934
Total Liabilities	\$ 31,856,138
Aggregate write-ins for special surplus funds	716,670
Common Capital Stock	1,200,000
Gross paid in and contributed surplus	5,852,698
Unassigned funds (surplus)	7,416,238
Surplus as regards policyholders	\$ 15,185,606
Total liabilities, surplus and other funds	\$ 47,041,744

**DIRECT GENERAL INSURANCE COMPANY OF MISSISSIPPI  
STATEMENT OF INCOME  
FOR YEAR ENDED DECEMBER 31, 2009**

<b>Underwriting Income</b>	
Premiums earned	\$ 34,548,057
Deductions:	
Losses incurred	22,829,913
Loss adjustment expenses incurred	4,172,879
Other underwriting expenses incurred	7,526,871
Aggregate write-ins for underwriting deductions	-
Net underwriting gain (loss)	<u>\$ 18,394</u>
<b>Investment Income</b>	
Net investment income earned	\$ 1,271,554
Net realized capital gains or (losses)	(26,151)
Net investment income	<u>\$ 1,245,403</u>
<b>Other Income</b>	
Aggregate write-ins for miscellaneous income	<u>\$ 163,098</u>
Net income before federal income taxes	\$ 1,426,895
Federal income taxes incurred	<u>267,450</u>
Net Income	<u><u>\$ 1,159,445</u></u>



**DIRECT GENRAL INSURANCE COMPANY OF MISSISSIPPI  
RECONCILIATION OF CAPITAL AND SURPLUS  
FOR EXAMINATION PERIOD ENDED DECEMBER 31, 2009**

	<b>2007</b>	<b>2008</b>	<b>2009</b>
Capital and surplus, beginning of year	\$12,976,039	\$14,530,638	\$13,494,055
Net income (loss)	1,845,095	928,034	1,159,445
Change in net unrealized capital gains or (losses)	-	(10,074)	10,074
Change in net deferred income tax	(26,373)	(78,021)	70,425
Change in nonadmitted assets	135,877	(437,797)	451,607
Dividends to stockholders	(400,000)	(1,438,725)	-
Examination adjustments	-	-	-
Capital and surplus, end of the year	<u>\$14,530,638</u>	<u>\$13,494,055</u>	<u>\$15,185,606</u>

**RECONCILIATION OF EXAMINATION ADJUSTMENTS TO SURPLUS  
DECEMBER 31, 2009**

As a result, of this examination, there have been no adjustments affecting Surplus as regards policyholders reported by the Company in the December 31, 2009 annual statement. The Surplus as regards policyholders reported by the Company of \$15,185,606 is accepted as reasonably stated for the purpose of the balance sheet per the examination

## **COMMITMENTS AND CONTINGENT LIABILITIES**

The Company's management and attorneys confirmed that there was no pending material non-policy related litigation or unreported commitments or contingent liabilities incurred through the examination date.

## **SUBSEQUENT EVENTS**

On December 14, 2010, the Company's board of directors unanimously adopted a resolution to voluntarily cease writing new and renewal business in Kentucky as soon as practical. The Company has experienced extraordinary losses in Kentucky which it believes are primarily attributable to increased fraud and the forecast for the state is continued deterioration.

On March 29, 2011, John Mullen was appointed to the position of CEO and President of the Company.

## **COMMENTS AND RECOMMENDATIONS**

There were no recommended adjustments to surplus as of December 31, 2009 based on the results of this examination.

### 1. Affiliated Agreements

#### Finding:

During the review of the Inter-party Cost Sharing Agreement and Federal Tax Agreement it was noted that the agreements did not contain settlement dates. SSAP No. 96, Paragraph 2, of the *Accounting Practices and Procedures Manual as of March 2009* published by NAIC states as follows:

"Transactions between related parties must be in the form of a written agreement. The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be non-admitted. If a due date is not addressed by the written agreement, any uncollected receivable is non-admitted."

As the inter-company receivables and payables under the above agreements were immaterial as of December 31, 2009, no adjustments were made in the examination report.

### **Recommendation**

**It is recommended the Company amend related party contracts to comply with the requirements SSAP No. 96, paragraph 2, which pertain to a specific settlement date, as the Mississippi Insurance Code §83-5-205 provides that the examination of Insurers shall be conducted based on the criteria set forth in *Examiners' Handbook* adopted by NAIC which utilizes the *Accounting Practices and Procedures Manual* as its standard in the conduct of Examination.**

## ACKNOWLEDGMENT

The examiners representing the Mississippi Insurance Department and participating in this examination were:

Examiner: Ed Fossa, CFE, CIE

Examiner: Aejaz Palejwala, CFE

Examiner: Alvin Burrell, CFE, AIE

Supervising Examiner: Cecil Thomas, CFE, CIE

Actuary: Robert Daniel, FCAS, MAAA

The courteous cooperation of the officers and employees responsible for assisting in the examination is hereby acknowledged and appreciated.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'R. Daniel', is written over a horizontal line.

Examiner-in-charge